Tullett Prebon Research, a blog by Dr Tim Morgan

Waning faith and credit

by Tim Morgan on February 25, 2013

Tempting though it is, one should not attach too much importance to the decision by Moodys to strip the UK of its AAA credit rating. For a start, credit rating agencies' own credibility hasn't recovered – perhaps it never will – from their role in the subprime fiasco. More to the point, this doesn't tell us anything we didn't already know – Britain is a debt-junkie, seemingly incapable of living within its means.

Even so, this is a useful opportunity to examine some basics. For a start, the government simply spends too much – too much, that is, not by any philosophical ideal, but relative to its revenue-generating capability.

Of course, tax rates can always be raised, and they have been. But here's why this doesn't work. If the government raises taxes on, say, high earners, it gets less money in, not more. Increase taxes on essentials and you might raise some money, but you impoverish working people, and the ones you hit the hardest are the poorest*. In short, you crimp spending capacity. Raise taxes on multinationals and many either leave or just don't pay up. Increase taxes on smaller businesses and the economy suffers. And so on.

In short, we're at the revenue limit. We have not only reached, but gone well beyond, the private sector's willingness or ability to fund the state.

Borrowing is neither a sustainable long-term option nor even a viable near-term one. Where interest rates are concerned, the rating downgrade can only add to the pressure which sterling is already under, and you cannot insulate domestic interest rates from the market. Of Britain's 11.5 million mortgage payers, most are on variable rates, and official figures show that a rate rise of just 2% would be enough to put half of these households in real trouble.

Don't even ask how a mortgage rate squeeze on household disposable incomes would affect the High Street, but do ask yourself what might happen to commercial real estate (and the banks) when rental streams dry up. Of course, if this were caused by rate rises, it would happen just as the domestic property market is imploding.

So that leaves us with spending cuts. It's not a nice option but, where Britain is right now, there are no good choices, only bad ones or worse ones. In a recent blog, I explained how the "vampire squid" of the permanent establishment drains the public services of funds. In America, Medicare spends 3% of its budget on management. In the NHS, that figure is 14%, and the difference between these numbers costs us £10bn annually.

Just think what you could do if you could save this £10bn. You could spend, say, £5bn annually on building social housing, thereby both kick-starting an important industry and beginning to tackle Britain's shameful housing shortage. The other £5bn could be used either to cut taxes (fuel duties, perhaps?), to put more money into patient care, or to show markets that we are going to tackle the deficit in time to avert a disastrous rise in interest rates.

It isn't just in the NHS, of course, where the mandarins' self-serving empire acts like a vampire squid. Having compared the NHS with Medicare, now extend this cost comparison across the public services – and across revenue-raising and redistribution, as well as direct service provision – and you begin to see how an arrogant, pampered state management class is bleeding Britain into bankruptcy.

Recent years have seen the public lose faith in politicians, the media, the police, bankers and now, perhaps, the BBC. After the Stafford scandal, even the NHS might be losing public support. The biggest single problem facing Britain now – bigger even than the looming energy crunch – is the cost of feeding the squid. Isn't it time we kicked this habit? After all, it could well be them or the rest of us.

*Within the escalating cost of essentials as measured by the Tullettt Prebon UK Essentials Index, incidentally, a very high proportion is controlled, either directly or indirectly, by the state.